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April 17, 2006

AGENDA ITEM 4b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: AIM Delegated Authority

II. PROGRAM: Alternative Investment Management (AIM) Program

III. RECOMMENDATION: Staff recommends approval of changes to its Delegated Authority as contained in the attached Delegation Resolution (marked to show changes)

IV. ANALYSIS:

The Strategic Review of the AIM Program, completed by Pension Consulting Alliance (PCA), was adopted by the Investment Committee in October 2005.

The Strategic Review recommended enhancements to the AIM Unit's delegated authority. At the March 14, 2006 Investment Committee meeting, the Investment Committee directed Staff to bring proposed changes to its delegated authority to the April 17, 2006 Investment Committee meeting for consideration.

The Strategic Review emphasized increased use of co-investing and new vehicles. It also highlighted the need to modify language in the delegation resolution to conform to the intent of the policy. The table below contains a summary of Staff's existing delegated authority levels along with a summary of proposed changes. Details of the substantive changes are provided further below.

AIM Program Delegated Authority Levels – Existing/Proposed

	EXISTING			PROPOSED	
	SIO Authority	**CIO Authority**		**SIO Authority**	**CIO Authority**
Top Quartile Funds	The lesser of **$400 million** or 20% of the partnership's total capitalization	The lesser of **$800 million** or 30% of the partnership's total capitalization		**No Change**	**No Change**
Second Quartile Funds	The lesser of **$100 million** or 10% of the partnership's total capitalization	The lesser of **$200 million** or 20% of the partnership's total capitalization		**No Change**	**No Change**
New Management Teams	The lesser of **$50 million** or 25% of the partnership's total capitalization	The lesser of **$100 million** or 25% of the partnership's total capitalization		**No Change**	**No Change**
Direct Investments	**$75 million**	**$75 million**		**No Change**	**No Change**
Co-investments	**$50 million**	**$75 million**		**$100 million**	**$200 million**
New Vehicles	**$75 million**	**$75 million**		**$400 million**	**$600 million**

<u>Justification</u>

Co-investments: The Strategic Review identified greater utilization of co-investing as a potentially attractive strategy for the AIM Program. A co-investment is defined as an investment made directly into a company by CalPERS alongside an existing fund. Typically, the General Partner does not charge a management fee or carried interest on the co-investment amount. Therefore, co-investing can be a very cost-effective means to invest capital in private equity. For alignment of interest purposes, CalPERS requires the fund to make an equal or larger investment in the company, and the co-investment amount can not exceed CalPERS' commitment to the partnership.

Currently, co-investments made by AIM are done so using 3rd party fiduciaries (i.e., consultants that provide due diligence assistance and prudence opinions). Staff will be further evaluating strategic options for co-investing later in the year, at which time it will bring recommendations forward to the Investment Committee.

The authority levels reflected in existing delegated authority for co-investments were established in June, 2000. Since that time, both fund sizes and deal sizes have increased substantially. The increase sought by Staff reflects the increased size of private equity transactions occurring in the marketplace today.

New Vehicles: A New Vehicle is defined as an investment whereby CalPERS partners with a third party that has a distinct competitive advantage in an industry, geographic region or investment style and CalPERS contributes a significant percentage of the capital or takes an ownership interest. As discussed at the March, 2006 Investment Committee meeting, the AIM Unit is pursuing several new vehicles that would be focused on specific market niches, including California underserved markets, clean energy/technology, emerging managers, international emerging markets, venture capital, and middle market. It is anticipated that these new vehicles would be structured as customized fund-of-funds or separate accounts. The New Vehicle evaluation and approval process will parallel that of other forms of AIM investments (i.e., due diligence assistance by consultant, prudence opinion, etc.)

In the past, the AIM Program has used New Vehicles as a means to deploy significant capital in sectors of private equity that CalPERS had identified as attractive and where CalPERS was positioned to partner with firms uniquely qualified to execute specified investment mandates. Although Staff currently has delegated authority for New vehicles (up to $75 million), all New Vehicles have been approved by the Investment Committee, primarily because Staff had limited experience with New Vehicles and size exceeded delegated authority levels. Over time, Staff has gained the experience necessary to execute these types of investments at a higher level. The proposed limits on New Vehicles are based primarily on size considerations of the aforementioned vehicles and Staff's ability to handle larger transactions.

Other Enhancements: Staff has worked with the Legal Office to develop changes to the existing delegation resolution for purposes of clarity and conformity with the intent of the resolution, consistent with the recommendations contained in the Strategic Review. For example, the definition of "new management team" would be modified from its literal definition (1st time fund only) to a definition that is more consistent with market norms for new teams or emerging managers (1st or 2nd time institutional funds). All proposed changes are reflected in the attached, black-lined version of the delegation resolution.

Conclusion

Consistent with the Strategic Review and Board policy, the proposed changes facilitate investments in a manner that is designed to improve the AIM Program's responsiveness to the market and enable AIM to commit to the best managers, all of whom have many other funding alternatives from which to choose.

PCA, the Consultant to the Investment Committee on the AIM Program, has provided an opinion letter regarding the proposed changes. The opinion letter is contained in Attachment 1. This agenda item has also been reviewed by the CalPERS legal office.

V. STRATEGIC PLAN:

Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions and Goal IX, achieve long-term, sustainable, risk-adjusted returns.

VI. RESULTS/COSTS:

Approval of this agenda item would result in increased limited delegation of authority to AIM Staff.

Prepared by: ______________________________
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